

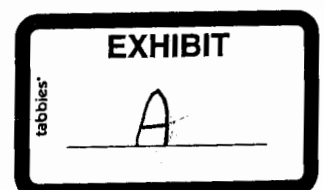
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MAY 19 2004

Dept. Of Commerce & Insurance  
Company Examinations

Report on  
Market Conduct Examination  
of  
**USAUTO INSURANCE COMPANY, INC.**  
Nashville, Tennessee

By Representatives of the  
Tennessee Department of Commerce and Insurance  
as of  
May 14, 2004



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**STATE OF TENNESSEE**  
**DEPARTMENT OF COMMERCE AND INSURANCE**  
INSURANCE DIVISION  
500 JAMES ROBERTSON PARKWAY - 4TH FLOOR  
NASHVILLE, TENNESSEE 37243-1135

May 14, 2004

The Honorable Paula A. Flowers  
Commissioner  
Tennessee Department of Commerce  
and Insurance  
500 James Robertson Parkway  
4<sup>th</sup> Floor  
Nashville, Tennessee 37243

The Honorable Alfred W. Gross  
Chairman, NAIC Financial Condition  
(E) Committee  
Commissioner  
Virginia Bureau of Insurance  
P.O. Box 1157  
Richmond, Virginia 23218

Sir and Madam:

Pursuant to your instructions and in accordance with Tennessee insurance laws and regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the market conduct practices of

**USAuto Insurance Company, Inc. (NAIC #10336)**

(hereinafter and generally referred to as "the Company") at its principal offices at 3813 Green Hills Village Drive, Nashville, Tennessee 37215. The report thereon is hereby respectfully submitted.

## **FOREWARD**

This report is written primarily by exception, except for certain items of regulatory significance, and those matters examined and found to be substantially in compliance with Tennessee statutes will not be commented on further. Standards as prescribed by the 2003 NAIC Market Conduct Examiners Handbook are only described in detail where the examiners concluded that Company was not meeting a specific standard. Such tests and review were conducted as were deemed necessary or appropriate to determine the Company's compliance with Tenn. Code Ann. § 56 and conformance to NAIC market conduct standards, and the details of these tests are included where relevant and supportive of the examiners' conclusions.

## **SCOPE OF EXAMINATION**

This is the first exclusively market conduct examination of the Company by the Tennessee Department of Commerce and Insurance (hereinafter referred to as the Tennessee Department). It commenced on December 8, 2003 and covers the period from January 1, 2002 through December 31, 2003, including relevant subsequent events. The examination was made and conducted by representatives of the Tennessee Department in accordance with criteria and standards as set forth in the NAIC Market Conduct Examiners Handbook (hereinafter referred to as the Handbook). These standards address the following aspects of the Company's operations:

Company Operations/Management  
Complaint Handling  
Marketing and Sales  
Producer Licensing

Policyholder Service  
Underwriting and Rating  
Claims

In the "Pertinent Factual Findings" caption of this report, standards referenced are those found in the Handbook under the appropriate section listed above.

## **PROFILE FACTS**

The Company was incorporated on July 12, 1995 pursuant to the provisions of the Tennessee Business Corporation Act as a for-profit corporation. Effective September 12, 1995, the Company was issued a Certificate of Authority to transact the business of property, vehicle, casualty and surety insurance in the State of Tennessee. The Company commenced business on October 7, 1995.

The Company writes private passenger non-standard automobile insurance for consumers who are unable to qualify for standard markets due to their driving history, or who are unable to financially handle the payment terms of standard markets. Coverage is provided primarily by six-month policies on which a down payment is made and the remaining balance is remitted in monthly installments.

Policies are written principally through Company-owned retail stores (operating under the name of "Acceptance Insurance") and business is solicited through television and telephone directory ads. The Company also has several captive relationships with independent agencies in the Memphis and Nashville, Tennessee, locales.

At December 31, 2003, the Company was licensed in Arizona, Arkansas, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Ohio, Oklahoma, Pennsylvania, South Carolina and Utah. However, the Company is currently only writing policies in Tennessee, Georgia, Mississippi, Missouri and Ohio.

The Company's direct written premium, by state, is presented as follows:

Date	Georgia	Mississippi	Missouri	Ohio	Tennessee
12/31/2002	20,681,059	3,029,707	1,477,725	811,117	23,398,464
12/31/2003	7,998,140	3,727,723	2,875,463	4,739,153	24,697,331

It is noted that the decrease in Georgia premiums is attributed to the Company's formation of a Georgia property and casualty insurer, Village Auto Insurance Company, Inc., through which it is now writing the majority of its Georgia policies.

The Company has two subsidiaries: Village Auto Insurance Company, Inc., a Georgia property and casualty insurer, and USAuto Services, Inc., a claims adjustment services provider incorporated in Delaware. The organization of the Company and its holding company system is presented in a chart attached to this report as Addendum A.

## EXECUTIVE SUMMARY

This is the first exclusively market conduct examination performed on the Company's operations and was not precipitated by any major Tennessee Department or industry concerns.

The Company is highly computerized. Even documents that are not inherently electronic, such as policy applications and forms that require signatures, are scanned into the Company's systems. Therefore, a great deal of the data required for the examination could be accessed directly by the examiners via the Company's LAN or sent by email.

Because of its computerized nature, the Company is susceptible to events which could interrupt operations and/or threaten the privacy of policyholders' electronic information. The Company, however, does not have a formal disaster recovery plan or

well-documented procedures for information management. Company management states that informal processes are in place and that more formal plans are currently being developed.

Other areas of concern include the Company's lack of formal producer (agent) training materials and the lack of a "closed" date on some of the Company's physical claim files. Appropriate recommendations are made in the body of this report and summarized under caption "Summarization: Examiner's Summary of Comments and Recommendations."

## **PREVIOUS EXAMINATION FINDINGS**

As this is the first market conduct examination performed on the Company operations by the Tennessee Department, there are no previous examination findings.

## **PERTINENT FACTUAL FINDINGS**

### **Company Operations/Management:**

#### **History:**

As discussed above, the Company was incorporated on July 12, 1995, issued a Certificate of Authority by the Tennessee Department effective September 12, 1995, and commenced business, writing primarily substandard automobile coverages, on October 7, 1995.

At its incorporation the Company was authorized to issue ten million (10,000,000) shares of common stock, each share to have a par value of one dollar (\$1.00). By Charter amendment dated September 15, 1995, the Company was given

“the authority to issue ten million (10,000,000) shares of common stock, par value \$2.00 per share.” Originally, all shares were held by eight individuals under a Shareholders Agreement dated August 2, 1995. However, effective December 31, 1998, the shareholders entered into a Stock Exchange Agreement whereby all of their capital stock in the Company and its affiliates was exchanged for the capital stock of USAuto Holdings, Inc. (Holdings), a Delaware corporation formed to be the parent of the holding company system. Each shareholder received the same proportion of Holdings stock as his previous holding in the Company. All shares of the Company are currently held by Holdings. A summary of the Company’s current capitalization at December 31, 2003 is presented as follows:

Date	Number of Authorized Shares	Par Value	Shares Issued and Outstanding	Common Stock	Gross Paid In & Contributed Surplus
12/31/2003	10,000,000	2.00	1,500,000	3,000,000	9,230,525

At December 31, 2003, the 75,000 outstanding shares of Holdings, which owns all shares of the Company, had been distributed as follows:

<u>Shareholder</u>	<u>Number of Shares</u>	<u>Percentage</u>
Stephen J. Harrison	18,750.0	25.00%
Thomas M. Harrison, Jr.	18,750.0	25.00%
James W. Ayers	18,562.5	24.75%
Joseph V. Russell	7,500.0	10.00%
Paul R. Cahn	3,750.0	5.00%
Jon Ayers	3,000.0	4.00%
E. Tony Reed	1,875.0	2.50%
T. R. Shelby	1,875.0	2.50%
R. Claybourne Petrey, Jr.	937.5	1.25%
Total	75,000.0	100.00%

In a transaction to take place in the near future, 100% of the stock of USAuto Holdings, Inc. will be acquired by Liberté Investors, Inc. (NYSE: LBI) for \$76 million in



cash and 13.25 million newly issued shares of Liberté's stock. Liberté Investors, Inc. will be renamed First Acceptance Corporation and relocate its headquarters to Nashville. It is anticipated that both Stephen and Thomas Harrison will remain significant shareholders in First Acceptance Corporation, but that the other current shareholders of Holdings will sell their shares to Liberté.

Profile:

Management: The Company's Bylaws state that "The business and affairs of the Corporation shall be managed under the direction of a board of directors." The following persons had been duly elected by the shareholders and were serving as members of the board at December 31, 2003:

Name	Business Address	Principal Occupation/Affiliation
Stephen J. Harrison	3813 Green Hills Village Dr., Nashville, TN 37215	President and CEO of the Company; 25.00% shareholder in the holding company, USAuto Holdings, Inc.
Thomas M. Harrison, Jr.	3813 Green Hills Village Dr., Nashville, TN 37215	Vice-president, secretary and COO of the Company; 25.00% shareholder in the holding company.
James W. Ayers	70 West Main St., Parsons, TN 38363	Vice-president of the Company; Chief Manager, Ayers Asset Management, LLC; 24.75% shareholder in the holding company.
Joseph V. Russell	630 Melrose Ave., Nashville, TN 37211	Vice-president of the Company; President, Elan Polo, Inc.; 10.00% shareholder in the holding company.

The Bylaws also provide that the board of directors shall elect "a president and a secretary, and such other officers as the board of directors shall from time to time deem necessary." At December 31, 2003, the following persons had been duly elected as officers and were serving in the positions indicated:

Stephen J. Harrison	President
Thomas M. Harrison, Jr.	Vice-President and Secretary
James W. Ayers	Vice-President
Joseph V. Russell	Vice-President
Michael J. Bodayle	Treasurer and Chief Financial Officer

Intercompany Agreement: Effective January 1, 1999, the Company and its affiliates entered into an agreement with their ultimate parent, USAuto Holdings, Inc. whereby "it is the intention of the Shareholders of Holdings that each Subsidiary operates on a stand-alone basis." However, it is also true that "certain Subsidiaries can offer services that will benefit other Subsidiaries." Under this agreement, Holdings and its subsidiaries attempt to allocate expenses based on actual costs and use of services. These costs include bank fees, information systems, payroll, underwriting, management salaries, rent and utilities. Intercompany balances are to be settled "on a monthly basis by cash payment" within 15 days after the end of each month.

The intercompany agreement also provides that: 1) the Company and its affiliated agencies shall "help market, sell and administer" the motor club memberships of another affiliate, Transit Automobile Club, Inc.; 2) USAuto Services, Inc., a subsidiary of the Company, shall provide the Company with claim adjustment services, and; 3) Acceptance Insurance Agency, Inc. (Acceptance), shall allow the Company "to utilize its credit card facility for accepting customer payments."

Employment Agreements: The Company maintains Employment Agreements with two directors, Stephen J. Harrison and Thomas M. Harrison, Jr. The agreements include a termination date of August 31, 2000, but also have a provision to

“automatically renew for an additional one (1)-year period unless the Company” or either Mr. Harrison delivers written notice 30 days prior to the renewal date. The agreements specify annual salary rates and provide for expense allowances.

Operations: The Company primarily writes private passenger auto liability and physical damage coverages on nonstandard risks. It offers “auto death indemnity coverage” as a policy endorsement, and tenant fire coverage as a separate policy that is billed with the auto coverages. It also markets and bills for the products of its affiliate, Transit Automobile Club, Inc., which offers several levels of benefits.

The Company markets its Tennessee products principally through 15 affiliated retail stores operating under the trade name of “Acceptance Insurance.” In 2003, approximately 60% of the Company’s Tennessee premiums were written through these stores and by agent/employees on a salary compensation basis.

The balance of the Company’s Tennessee business is written through several independent insurance agencies in Tennessee and an exclusive agency in Memphis. The independent agencies are compensated by commissions based on a percentage of earned premiums. The Memphis agency is compensated by commissions and a major share of the monthly billing fees from Company business written. The Memphis agency also receives any contingent commissions paid to the Company under reinsurance treaties as the result of favorable loss experience on the agency’s business.

Georgia policies are written through an affiliate, Acceptance Insurance Agency, Inc. (Acceptance), which was acquired by the Company in 1998. See further discussion under section “MGA Oversight,” below.

An affiliated agency, Acceptance Insurance Agency of Tennessee, Inc., formerly Harrison Brothers Insurance Agency, Inc., conducts incidental general insurance agency operations in Tennessee.

The Company's Mississippi, Missouri and Ohio policies are written by agent/employees through Company-owned retail stores in those states. There are seven locations in Mississippi, seven in Missouri and 22 in Ohio.

The Company reinsures 15% of the new and renewal private passenger auto business underwritten by Vesta Insurance Corporation (Vesta), an Illinois domiciled insurer located in Birmingham, Alabama. These policies are written on behalf of Vesta by Acceptance Insurance Agency, Inc. in the states of Georgia and Alabama, and by Alabama Acceptance Insurance Agency, Inc. in the state of Alabama.

Under an ongoing quota share agreement, the Company cedes 50% of its new and renewal private passenger auto business to Transatlantic Reinsurance Company.

Certificates of Authority: At the date of this report, the Company was licensed in the following states:

Arizona	Mississippi
Arkansas	Missouri
Georgia	Ohio
Illinois	Oklahoma
Indiana	Pennsylvania
Iowa	South Carolina
Kansas	Tennessee
Kentucky	Utah
Louisiana	

The types of insurance authorized were reviewed for each Certificate of Authority and the Company's operations are deemed to be in conformance with such.

The Company has pending license applications in Alabama, California, Colorado, Florida, Michigan, Nevada, New Mexico, North Carolina, Texas, Virginia, West Virginia and Wisconsin. An application to Minnesota has been withdrawn.

The Company's Tennessee Certificate of Authority allows it to transact the business of property, vehicle, casualty and surety business. Currently, the Company writes business in Georgia, Mississippi, Missouri, Ohio and Tennessee only.

MGA Oversight:

Effective September 1, 2001, the Company entered into a managing general agency (MGA) agreement with its affiliate, Acceptance Insurance Agency, Inc. (Acceptance), a Georgia corporation, in which the Company appoints Acceptance as its MGA "for the production, and underwriting, and servicing of Personal Nonstandard Automobile Policies and Renters Fire Policies." The agreement extends only to the Company's Georgia policies.

Under the agreement, Acceptance shall earn a commission of "18.5% of the gross net premiums collected (gross premiums collected less return premiums paid)" which is based on "rates currently paid to the MGA by other non-affiliated entities." Balances are to be remitted monthly.

The MGA agreement was submitted to the Tennessee Department for approval on January 22, 2002. By letter dated May 7, 2002, the Department informed the Company that its relationship with Acceptance under this agreement "violates the pecuniary interest prohibition found in Tenn. Code Ann. § 56-3-103" which states that

"No director or other officer of any domestic insurance company organized under the laws of Tennessee, . . . shall accept, or be the beneficiary of, either directly or remotely, any fee, brokerage, commission, gift, or other consideration for or on account of any loan, deposit, purchase, sale, payment or exchange made by or in behalf of such company, or be pecuniarily

interested in any such purchase, sale, or loan, either as borrower, principal, coprincipal, agent, or beneficiary, . . .”.

In response, the Company amended the MGA agreement effective January 1, 2002 to provide for commissions to be paid to Acceptance at the rate of 0% of premiums. Subsequently, on September 19, 2002, the Company formed Village Auto Insurance Company, Inc., a Georgia property and casualty insurer. Nearly all of the Company's Georgia business is now written through this subsidiary. Premiums written through Acceptance are in run-off and have decreased to an immaterial amount.

#### Internal Audits:

Standard 1, Company Operations/Management, recommends that the Company have “an up-to-date, valid internal **or** [emphasis added] external audit program.” The Company's only internal audits are those performed on claim files by a full-time claims auditor. However, the Company is audited annually by an independent CPA firm in accordance with Tenn. Code Ann. § 56-1-501(h), and as such, appears to be in conformance with Standard 1.

#### Antifraud Initiatives:

The Company has a written antifraud plan and investigative personnel in order to detect, prosecute and prevent fraudulent insurance acts.

#### Disaster Recovery Plan:

The Company does not have a formal written disaster recovery plan, but according to management, is in the “process of putting together a more formal plan.” It does have “informal agreements with another insurance company in town [more precisely, a non-standard auto managing general agency located in Brentwood, Tennessee] to use each other as a hot site in the event of an emergency” notes that

system programs can easily be loaded onto a remote computer. It also has "agreements with IBM to give 24-hour turnaround for a replacement system in the event of a total system disaster." In addition, backup copies of data are cycled offsite on a daily basis.

The Company does not appear to meet Standard 4, Company Operations/Management, which stipulates that a disaster recovery plan be current as well as "valid, specific and operational with procedures for implementation."

#### Computer Systems:

The Company runs a Specialty Insurance Service (SIS) software system, which has been customized for its operations, on an IBM AS400 mainframe computer. It has an additional AS400 as a backup. Access to the SIS system, and other programs such as Microsoft Word and Excel, is provided to individual workstations though a local area network (LAN) server operating with a 400 megahertz Intel Pentium II processor. Access to programs and data is limited in accordance with each employee's function and authority by login and security codes.

Almost all underwriting, rating and claim information is available electronically through the Company's AS400 systems. Documents that require signatures, such as applications, are scanned and available in pdf format.

The Company has a website at [www.acceptanceinsurance.com](http://www.acceptanceinsurance.com) through which prospective Georgia insureds can get a quote for automobile insurance. Applicants must first electronically "agree" to the Company's privacy statement before accessing the quote screen.

Privacy:

The Company's Privacy Statement was reviewed and appears to comply with Tenn. Reg. 0780-1-72 which was effected November 13, 2001. The statement is included and presented to each policyholder with each new and renewal policy; almost all policies are renewed every six months. Also, applicants are required to "accept" the Privacy Statement electronically before getting a policy quote on the Company's website.

The Company's employee handbook includes a section on the confidentiality of Company records, and privacy of information is reiterated in new employees' training.

The Company's procedures for privacy and the management of insurance information are not extensive, but appear to be adequate to the Company's operations.

**Complaint Handling:**

The Company maintains a log and files for the complaints that involve a regulatory agency such as a state insurance department or the Better Business Bureau.

The Company received 36 complaints in 2002 and 42 in 2003 through December 11.

Complaints by state are presented as follows:

<u>State</u>	<u>2002</u>	<u>2003</u>
Tennessee	19	11
Alabama	6	10
Georgia	9	7
Mississippi	0	7
Missouri	1	3
Ohio	1	4
Total	36	42



The examiners reviewed 16 complaint files representing each state in which the Company writes business to determine whether the Company is handling complaints in a timely, fair and consistent manner. Files were found to contain adequate documentation of communication with complainants and regulatory agencies, and support for the final disposition of the complaint.

Some common types of complaints are:

- Claim denied due to lapsed policy (usually lapsed for nonpayment of premium);
- Claim denied for other reasons;
- Amount of loss settlement not satisfactory;
- Rental reimbursement not adequate;
- Prior damage not covered with current claim.

The Company does not log written complaints that do not involve a regulatory agency because it receives very few. However, management has indicated that a separate logging system will be implemented to more fully meet Standard 2, Complaint Handling, which recommends that the Company have "adequate complaint handling procedures in place." General inquiries and grievances received via telephone are documented by notes entered into the insureds' electronic policy files.

### **Marketing and Sales:**

A review was conducted of the marketing and sales materials provided by the Company to determine compliance with the provisions of Tenn. Code Ann. § 56-8-104, "Unfair methods of competition and unfair or deceptive acts or practices." Policy benefits, limitations and exclusions appear to be fairly disclosed with no misleading or incomplete statements noted. All documentation reviewed appeared to be in

compliance with statutes and regulations and no unlawful marketing practices were disclosed.

The Company does not advertise under its own name, but does fund television spots and telephone directory ads under the trade name of "Acceptance Insurance." The examiner reviewed four television commercials that are aired in Tennessee and four that are aired in Georgia, along with telephone directory ads for 43 municipalities in Tennessee and multiple locations in Georgia and Mississippi. The Company's website, which can be found at [www.acceptanceinsurance.com](http://www.acceptanceinsurance.com) as noted above, was also perused. There were no unlawful rebates or inducements offered, nor were there any other violations noted with respect to the promotional material reviewed.

Standard 2, Marketing and Sales, recommends that examiners ensure that the Company's "internal producer training materials are in compliance with applicable statutes, rules and regulations." However, management stated that no such materials are employed by the Company as new marketing personnel are trained by existing agents. Thus, the Company may not be fully meeting the above cited standard.

### **Producer Licensing:**

The purpose of the producer licensing review is to test the Company's compliance with state producer licensing laws and rules and to attempt to detect any fraud or misuse of funds held by the producers.

The examiners reviewed and compared information obtained from state insurance department websites and company records pertaining to licenses held by individuals and entities soliciting business on behalf of the Company. No producers

were found to be incorrectly or inadequately licensed to solicit business for the Company; and thus the Company is deemed to be meeting the Handbook standards for producer licensing.

### **Policyholder Service:**

Most of the policyholder service functions of the Company are performed via telephone conversations by the underwriting and claims departments in response to insureds' queries. Correspondence related to claims is maintained in the claim files. Other correspondence, such as that requesting cancellation, is scanned into the Company's computerized policy system.

The Company's policy records were reviewed for timely execution of policy issuance, insured-requested cancellations, claims history requests and premium invoices mailing as follows:

A policy is bound by the agent on the day that the application is complete and the premium deposit is paid. The application is received the next day by the Company's underwriting department and a policy is issued in a few days. On average, policies were issued in 2.6 days in February 2004.

Cancellation requests require the insured's signature for processing. Premium refunds are issued within ten days of the cancellation request, providing that the insured's original premium payment is not sent back to the Company NSF (non-sufficient funds) and that any lien holders are given sufficient notification prior to the cancellation date. Premium refunds checks resulting from cancellations require three

separate reviews and approvals. All refunds, regardless of reason, are calculated on a pro-rata basis.

As the Company files claims data with the Insurance Services Organization (ISO) that is accessible by other insurers, policyholder requests for claim histories are rare and are usually processed and mailed or faxed out the same day the request is received.

Premiums are billed monthly and invoices are sent out approximately one week in advance of the due date.

### **Claims:**

#### **General Overview:**

The examination process is to provide a view of claim practices in order to determine that the Company's treatment of claimants is in compliance with applicable statutes, rules and regulations, particularly Tenn. Code Ann. § 56-8-104(8). The Company provided a complete listing of claims, both open and closed, for the examination period. From this listing a sample of 95 claims was extracted by ACL, a data analysis and extraction program, based on a 95% confidence level and an expected error rate of 1% or less.

#### **Time Studies to Measure Acknowledgement, Investigation and Settlement Times:**

The Company's claims are processed by its affiliate, USAuto Services, Inc., under an intercompany agreement, as noted previously in this report. Claims for the period January 1, 2002 through December 31, 2003 (more than 66,000 records) were reviewed for timeliness of payments which was measured as the number of days from

the date the claim was reported to the Company to the date that the claim was closed.

This data is presented as follows:

Days to Close	Claims Closed Without Payment:				Claims Closed With Payment:			
	Liability		Physical Damage		Liability		Physical Damage	
<30	7,748	62.22%	7,600	70.01%	7,908	38.01%	9,891	55.04%
31-60	1,974	15.85%	1,804	16.62%	4,370	21.01%	3,673	20.44%
61-90	1,004	8.06%	646	5.95%	2,335	11.22%	1,513	8.42%
91-120	592	4.75%	260	2.39%	1,540	7.40%	998	5.55%
121-150	323	2.59%	105	0.97%	1,075	5.17%	640	3.56%
151-180	233	1.87%	41	0.38%	789	3.79%	421	2.34%
181-210	133	1.07%	24	0.22%	614	2.95%	242	1.35%
211-240	89	0.71%	55	0.51%	434	2.09%	166	0.92%
241-270	50	0.40%	33	0.30%	323	1.55%	106	0.59%
271-300	42	0.34%	34	0.31%	238	1.14%	57	0.32%
301-330	44	0.35%	29	0.27%	214	1.03%	62	0.35%
331-360	26	0.21%	32	0.29%	183	0.88%	30	0.17%
360+	195	1.57%	193	1.78%	780	3.75%	171	0.95%
	12,453	100.00%	10,856	100.00%	20,803	100.00%	17,970	100.00%

The close date is defined as the date that the final claim payment was made or that sufficient information was available to determine that the Company had no liability.

#### General Handling Study:

The ACL sample of the Company's claim files was reviewed for adequate and accurate documentation. Electronic claim records, as maintained by the Claims Management System on the Company's AS400, were compared to claim files for accurate recording of identifying data such as claim/policy number, date of loss, claimant name, limits of coverage and deductibles. Claim and expense checks were reviewed for correct payees.

Standard 5, Claims, requires that claim files be "adequately documented." In 29 of 87 closed files reviewed (33.3%), no definitive closing date could be located in the physical file, although a note to close the file is usually included in the Claims Management System file. To fully meet Standard 5, it is recommended that all closed

claim files indicate a “closed” date in a conspicuous location on or in the physical file. Company management implemented procedures to comply with this recommendation during the examination.

Total Loss Survey:

The Company’s claim files were reviewed for consistency of vehicle evaluation, correct disposition of salvage and compliance with state requirements for transfer of title and registration. The Company uses the Kelley Blue Book to calculate depreciation and salvage values. No exceptions were noted in the Company’s valuation of total loss.

Closed Without Payment Review:

Claims closed without payment includes those that are denied or rejected for specific reasons stated in the auto insurance policy, and those that are incomplete as to adequate documentation. Out of the 95 claims in the sample, 29 were closed without payment. Most involved either damages below the insured’s deductible amount or no coverage according to policy provisions. Only two files indicated no payment due to the lack of interest from the claimant and failure to cooperate with Company claim adjusters. One claim was rejected because the operator of the vehicle was driving without a license. No files were deemed to be incomplete as to adequate documentation.

Subrogation Survey:

The purpose of this procedure is to review a representative sample of the subrogated files with complete or partial recoveries. Of the more than 62,000 closed claims in the examination period population, only two claims involving subrogation recovery were selected by ACL for the sample of 95. Therefore, an additional sample

of ten recent subrogation claims was selected for review. The files were found to contain adequate documentation of the Company's recovery efforts and return of deductible to insureds where appropriate.

The Company does not maintain a subrogation and salvage logs; these records are maintained in the individual claim files. As noted above, the Company uses the Kelley Blue Book to calculate salvage and depreciation amounts.

#### Litigation Survey:

A sample of twelve claims in litigation were selected for review to determine the basis for suit and the Company position for denial or settlement offer. Files were found to contain adequate documentation of the Company's position with no evidence of bad faith judgments.

#### Unfair Claim Practices Review:

The examiners reviewed the sample claim files for violations of specific state unfair claim practices such as misrepresentation of policy provisions, concealment of coverage, and failure to promptly settle claims where liability has become reasonably clear. No material exceptions were noted.

The Company maintains a log for claims that were denied based on coverage issues. The most common coverage issues resulting in claim denial are lapsed policy due to nonpayment of premium, unlicensed driver, premium payment returned as NSF (non-sufficient funds), and policy expired prior to loss date. The examiners reviewed the Company's documentation supporting decisions for a sample of denied claims and determined that the denials were appropriate and in accordance with policy provisions.

#### Claim Forms:

The Company's claim forms were reviewed for content and appropriate and consistent usage. Reported claims are entered directly in the Claims Management System on the AS400 system by the Company's claims adjusters. Claim forms in use include a Recorded Statement Summary, a Bodily Injury Evaluation, a Med Pay/PIP Payment Log, a Salvage Update, a Subrogation Transmittal Form and a Reserve Request Form. Claim files were found to contain adequate documentation that included completed forms as appropriate.

#### Loss Statistical Reporting:

The purpose of this procedure is to review claim payments to determine if loss data is correctly coded as to the proper line of business and coverage. The Company uses several abbreviation/codes for loss expenses and payments; incorrect codes are rejected by the Claims Management System. No material miscoding was noted in the examiners' review of claims and claim files.

#### Review of Canceled Drafts/Checks:

The Company maintains copies of all claim and expense checks in each individual claim file. The examiners reviewed copies of these to verify that the amount paid and the claim amount approved were the same, that payees were the same, and that the information recorded in the AS400 system matches what is on the check. All information listed on the checks was verified to the AS400 claims management system without exception.



## **Underwriting and Rating:**

### **Rates and Policy Forms:**

TCA 56-3-305(a) requires that insurers file with the Tennessee Department "all rates, supplementary rate information, supporting information, policy forms, and endorsements at least thirty (30) days before the proposed effective date."

Rates for the Company's Tennessee auto policy were most recently approved by the Tennessee Department on November 12, 2003 for new business effective December 8, 2003 and December 30, 2003 renewals.

Rates in use in other states are summarized as follows:

<u>State</u>	<u>Approval Date</u>	<u>New Business</u>	<u>Renewals</u>
Georgia	09/02/2003	11/17/2003	12/09/2003
Mississippi	04/07/2003	04/28/2003	05/20/2003
Missouri	None required	10/06/2003	10/28/2003
Ohio	12/29/2003	12/29/2003	01/20/2004

Until the Ohio rates are approved, the Company is using rates last filed in June 2003.

In 2001, the Company began offering tenant fire coverage in all states in which it writes business. For stated amounts up to \$15,000, the coverage insures "household contents, meaning personal property, usual to a dwelling" against specific perils. The Tennessee policy form and rates for this product were filed with the Tennessee Department on June 5, 2001 and approved on July 9, 2001.

A sample of 72 policies from all states in which the Company writes business was selected to verify that premiums charged were calculated in accordance with filed and approved rates and underwriting guidelines. No exceptions were noted.

The Company writes six-month policies, with the exception of the Memphis agency which also writes annual policies. Premiums may be paid in full or according to a payment plan under which insureds pay 1/6 down (1/12 down on the annual policies) and are billed for the balance in monthly installments. An initial policy fee and monthly billing fees apply, as does a fee for reinstatements. Monthly billings in Tennessee show pertinent policy data, including a breakdown of coverages for the entire policy period, and contain the following statement:

"If you have any questions, please call [local telephone number]. A \$15.00 reinstatement fee will be charged to any balance if payment is received after your cancellation date."

As the billings do not indicate a specific cancellation date, this statement might be more clear to policyholders if it referred to the due date on the invoice. The invoices for other states differ according to their reinstatement and/or other fees.

The Company utilizes a form called a "Statement of No Loss" for reinstatements. When an insured's policy lapses for nonpayment of premium, the Company offers the insured the option of reinstating the policy with no lapse of coverage if the insured will sign the Statement of No Loss attesting that no loss was suffered on the risk(s) insured between the lapse date and the date of reinstatement.

In accordance with TCA 56-7-1201(a), the Company's Tennessee policy applications offer uninsured motorists' coverage. If the coverage is not desired, applicants must reject the coverage by signing an "Uninsured/Underinsured Motorists Coverage Statement."

The Company offers motor club memberships with Transit Automobile Club, Inc., an affiliate, and Memphis Automobile Club, Inc., an affiliate of the Company's exclusive

agency, as mentioned under caption "Company Operations/Management." Motor club benefits include reimbursements for bail bonds, legal fees, towing and car rental. The Company sells the memberships, collects membership fees and maintains each club's records. In accordance with the intercompany agreement discussed previously, the Company earns commissions based on a percentage of motor club fees earned. The Company administers the Memphis motor club free of charge as the parties view the motor club memberships "as a benefit to their mutual policyholders and an enhancement to their operations." Fees collected by the Company are remitted to the club on a monthly basis.

The Company also collects, free of charge, premiums for a hospital indemnity policy underwritten by Lloyds Underwriters under a group policy issued to Nation Safe Drivers. The policy offers three options of varying amounts of accidental death and dismemberment coverage, accident medical expense and daily in-hospital benefits. Only renewals of this coverage are now being written as the Company has begun offering its own accidental death coverage as a policy endorsement.

Underwriting:

The Company writes non-standard automobile policies which provide primary coverage limits in Tennessee as follows:

<u>Coverage</u>	<u>Basic Limits</u>	<u>Excess Limits</u>
Bodily injury per person	\$25,000	\$100,000
Bodily injury per occurrence	\$50,000	\$300,000
Property damage per occurrence	\$10,000	\$ 50,000
Physical damage per vehicle	\$50,000	\$ 50,000

Excess limits are available for leased vehicles. The basic limits vary slightly in the other states in which the Company writes in accordance with those states' statutory requirements.

Various endorsements such as for non-owner coverage and accidental death coverage are available. Discounts are given for renewals on loss-free policies, prior insurance, multi-car coverage, homeownership and senior citizen safe driver courses. Examples of vehicles ineligible for coverage include those with load capacities in excess of  $\frac{3}{4}$  ton, recreational vehicles and motor homes, vehicles driven more than 36,000 miles annually, vehicles with a cost new or current actual cash value in excess of \$50,000, and antique, restored, custom built or limited production vehicles.

#### Use of Correct and Properly Filed Forms and Endorsements:

As noted above, TCA 56-3-305(a) requires that insurers file Tennessee policy forms and endorsements with the Tennessee Department at least 30 days prior to their use.

The examiner reviewed the policy forms filed by the Company during the examination period to confirm that they had been duly filed and approved for use in states in which the Company is currently writing business. The Company's Tennessee automobile policy form was approved by the Tennessee Department on November 12, 2003.

#### Termination Practices:

The Company's billings do not separate the amount owed into the individual costs for insurance premiums, additional coverages such as tenant fire, and motor club membership fees for each monthly invoice. The invoices do list the entire period

(usually semi-annual) premium for each coverage (eg., bodily injury), auto death indemnity coverage, motor club membership, and the monthly billing fee. The Company's premium receipts system does not allow for amounts received to be allocated between premium and motor club memberships or other charges, other than policy billing or reinstatement fees. This means that an insured could send in an amount less than what was billed, but sufficient to cover the insurance premium portion of the billing, and still be considered in arrears on the policy. Cancellations and reinstatements are processed based on the entire amount receivable, including fees. It is noted that the Company has not received any complaints regarding this practice.

The Company's Tennessee cancellation notices include the reason for cancellation or and the following statement:

"Under the statutes of the state of Tennessee, we are required to give a ten day NOTICE OF CANCELLATION. If this insurance has been cancelled or non-renewed for any reason other than non-payment of premiums, you are possibly eligible for automobile insurance through another insurer or the TENNESSEE ASSIGNED RISK PLAN (56-7-1305)."

Return premiums are calculated pro-rata regardless of the reason for termination.

#### Declination Practices:

The Company rarely declines a prospective insured as the online policy system rejects applications that contemplate risks outside of the Company's underwriting guidelines. If a policy is written and it is then discovered that the insured vehicle is being used for pizza or newspaper delivery, or some other risk which was not disclosed by the specific questions on the application, the policy will simply be non-renewed at the end of the payment month.

#### Reinsurance:

Tenn. Code Ann. § 56-3-116 states that “no insurance company engaged in the business of property and casualty insurance shall retain a maximum net amount on any single risk in excess of ten percent (10%) of such company’s capital.” As the Company’s net aggregate amount insured in any one risk is \$200,000, and at December 31, 2003, capital totaled \$16,768,825, it appears that the Company is in compliance with the referenced statute.

#### Statistical Coding:

The Company’s policy system is updated with each new rate and form filing, and will not process incorrect entries. The Company’s underwriting manual is specific as to how data can be entered into the system.

### **SUMMARIZATION**

#### Summary of Examiners’ Comments and Recommendations:

<u>Page</u>	<u>Recommendation</u>
13	It is recommended that the Company develop a formal disaster recovery plan to meet Standard 4, Company Operations/Management, which stipulates that a disaster recovery plan be current as well as “valid, specific and operational with procedures for implementation.”
19	It is recommended that all of the Company’s closed claim files indicate a “closed” date in a conspicuous location on or in the physical file to fully meet Standard 5, Claims, which requires that claim files be “adequately documented.”

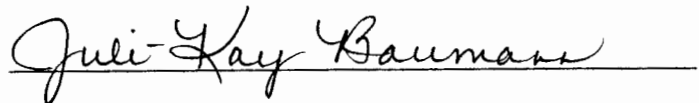
<u>Page</u>	<u>Comment</u>
15	The Company does not log written complaints that do not involve a regulatory agency because it receives very few. However, management has indicated that a separate logging system will be implemented to more fully meet Standard 2, Complaint Handling, which recommends that the Company have "adequate complaint handling procedures in place."
16	The Company may not be fully meeting Standard 2, Marketing and Sales, which recommends that examiners ensure that the Company's "internal producer training materials are in compliance with applicable statutes, rules and regulations" as no such formal materials are employed by the Company.

Conclusion:

An examination has been conducted of the market conduct affairs of USAuto Insurance Company, Inc. for the period January 1, 2002 through December 31, 2003 with analyses of certain operations of the Company being conducted through first quarter 2004. The examination was performed in accordance with Tennessee insurance laws and regulations and market conduct procedures as promulgated by the NAIC.

The extremely timely cooperation of the officers and employees of the Company, its parent and affiliated companies extended during the course of the examination is hereby gratefully acknowledged.

Respectfully submitted,



Juli-Kay Baumann, ARM, ARe, AIE, CFE, CPCU  
Examiner-in-Charge  
Representing the Tennessee Department  
of Commerce and Insurance  
Southeastern Zone, NAIC

Affidavit:

The undersigned deposes and says that she has duly executed the attached market conduct examination report of USAuto Insurance Company, Inc., dated May 14, 2004, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of her knowledge, information and belief.

Juli-Kay Baumann

Juli-Kay Baumann, ARM, ARe, AIE, CFE, CPCU  
Examiner-in-Charge  
Representing the Tennessee Department  
of Commerce and Insurance  
Southeastern Zone, NAIC

Subscribed and sworn to before me this  
14th day of May, 2004.

Notary: Rick Keyser

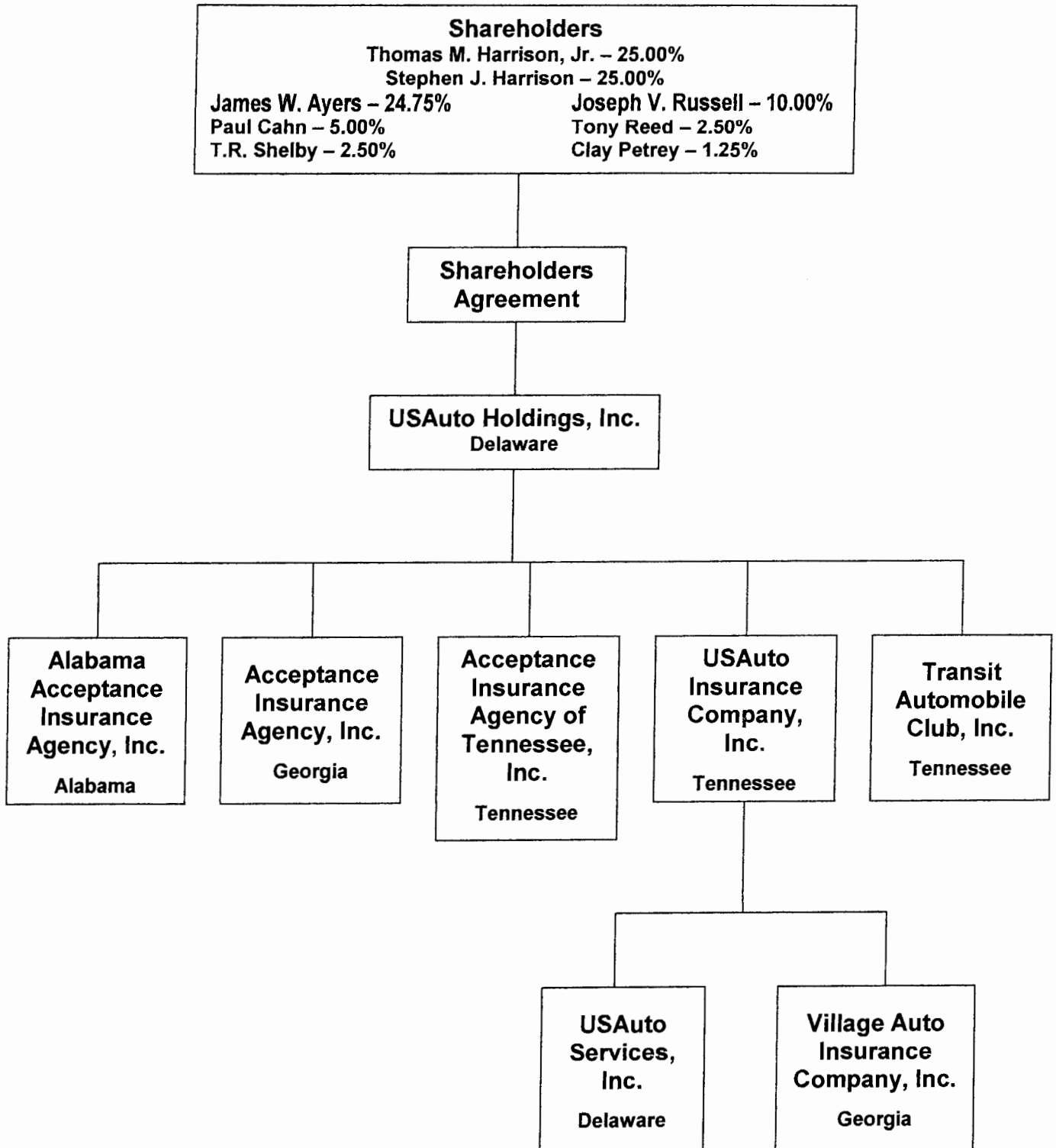
County: BLOUNT

State: TENNESSEE

My commission expires: 6/18/2005



## APPENDIX A



# USAuto

Insurance Company, Inc.

RECEIVED

JUN 04 2004

Dept. Of Commerce & Insurance  
Company Examinations

Mike Bodayle  
Treasurer & CFO  
615-844-2907  
mbodayle@usauto.com

RECEIVED

JUN 04 2004

Dept. Of Commerce & Insurance  
Financial Affairs / Analytical Section

June 1, 2004

Mr. Don Spann, CFE  
Insurance Examination Director  
State of Tennessee Department of Commerce and Insurance  
500 James Robertson Parkway  
Nashville, TN 37243

**RE: Market Conduct Examination of USAuto Insurance Company, Inc.  
Made as of May 14, 2004**

Dear Don:

The following is in response to the "Summary of Examiners' Comments and Recommendations" as summarized on pages 28-29 of the above-mentioned report.

1. The Company agrees with the comment that a formal disaster recovery plan be developed. This matter has been turned over to Richard Osgood, the Company's recently hired Director of Compliance. Mr. Osgood will work with the Company's Chief Information Officer to formally document the current informal specific processes and arrangements employed.
2. With regard to the recommendation that all of the Company's closed claims files indicate a "closed" date in a conspicuous location on or in the physical file, the Company is now utilizing a date stamp. All files are now being stamped on the front outside of the file jacket noting the date that the file was closed. This criteria has also been added to the list of steps to be reviewed as claims files are subjected to internal claims audits.
3. We agree that, in the past, the Company has not logged written complaints that did not involve a regulatory agency because it received very few. However, the Company has immediately taken the steps to maintain the complaint calls logged by each unit on an Excel spreadsheet kept by both directors of claims. This report is readily available for management and the state's review at any time and details the verbal or written complaints received by the Company and not funneled through a regulatory agency.
4. The Company currently does not maintain "internal producer training materials" as training is all on-the-job under the supervision of existing agents. We do agree however that benefits can be obtained from having formal written materials. Likewise, this matter has been

EXHIBIT

B

tabbles

June 1, 2004

Mr. Don Spann, CFE

State of Tennessee Department of Commerce and Insurance

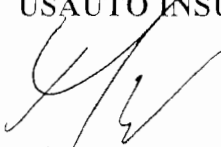
Page 2

turned over to Mr. Osgood and will be developed together with the Senior Vice President of Marketing. This process will involve the accumulation of current existing materials and the development of new materials that will be combined together as an "Agent Training Guide."

The Company had no other comments about the accuracy of any matters contained in the report. In addition, the professionalism and courtesy of your examination team was greatly appreciated.

Yours truly,

**USAUTO INSURANCE COMPANY**



Mike Bodayle

Treasurer and Chief Financial Officer